Supreme Court of the United States

OCTOBER TERM, 1944.

No. 1181

BUTLER DISMAN, PETITIONER,

VS.

SECURITIES AND EXCHANGE COMMISSION, RESPONDENT.

In the Matter of the Application of Securities and Exchange Commission to Enforce a Plan for Reorganization of the Southern Colorado Power Company; an Operating Public Utility Corporation.

PETITION FOR WRIT OF CERTIORARI AND BRIEF IN SUPPORT THEREOF.

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PETITION FOR WRIT OF CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE TENTH CIRCUIT.

To the Honorable Harlan Fiske Stone, Chief Justice, and the Associate Justices of the Supreme Court of the United States:

Comes now Butler Disman, of Kansas City, Missouri, and respectfully prays for a writ of certiorari to the Cir-

cuit Court of Appeals, for the Tenth Circuit, to review a decision and judgment rendered by said court in the above matter on February 21, 1945. The opinion of the Circuit Court of Appeals was *per curiam* and affirmed a final order entered by the United States District Court for the District of Colorado approving a plan of reorganization that was submitted and proposed by the Southern Colorado Power Company, hereinafter referred to as Power Company, under Section 11 (e) of the Public Utility Holding Company Act of 1935, 49 Stat. 803, 15 U. S. C. A., Sec. 79 (a), and following Sections of said Act, to comply with the requirements of Section 11 (b) thereof.

OPINIONS BELOW.

The oral opinion of the District Court, dated December 21, 1943 (unreported), is printed in Record 108. The opinion of the Circuit Court of Appeals for the Tenth Circuit, dated February 21, 1945 (unreported), is attached to the printed record as an addition (R. 125 and 126).

A certified transcript of the record before the Circuit Court of Appeals, and the proceedings in said Court is presented herewith in accordance with Rule 38 of this Court.

JURISDICTION.

This application is made under Section No. 240 (a) of the Judicial Code as amended (28 U. S. C. A., Sec. 347 a).

STATUTES INVOLVED.

Public Utility Holding Company Act of 1935, 49 Stat. 838, 15 U. S. C. A., Sec. 79 a, *et seq.*; Sections 11 (b) (1),

(2) and (e) of said act. Statutes of Colorado Annotated, Sections 48 and 52, Subdivision 3 of Chapter 41.

SUMMARY STATEMENT OF MATTERS INVOLVED.

This case originated in the United States District Court for the District of Colorado on an application by the Securities and Exchange Commission, under Section 11 (e), 18 (f), of the Public Utility Holding Company Act of 1935, 49 Stat. 803, 15 U. S. C. A., Sec. 79 (a) *et seq.*, hereinafter referred to as the Act, for approval of a plan of reorganization designated therein as a plan for recapitalization, that was proposed by the Power Company, as fair and equitable to the persons affected by such plan, and as appropriate to effectuate the provisions of Section 11 (b) of the Act. The District Court found the plan to be fair and equitable to the persons affected thereby and as necessary and appropriate to effectuate the provisions of Section 11 of the Act, and entered an order directing that the plan be put into effect.

Petitioner as the owner of seventy-five shares of the cumulative preferred stock of the Power Company contends (1) that since the Power Company is an operating electric utility company, as distinguished from a holding company, the Act does not empower the Commission or the District Court to approve the plan; (2) that the Plan is neither necessary nor appropriate to effectuate the provisions of the Act; (3) that the plan is neither fair nor equitable to the holders of the preferred stock; (4) that the Plan is not feasible in that it requires a violation of the laws of the state of Colorado for its enforcement, and should not have been approved; (5) that if the act be so construed as to authorize said Plan, then said Act denies to the preferred shareholders equal pro-

tection of the laws and deprives them of their property without due process of law, in violation of the provisions of Amendment V to the Constitution of the United States.

SUMMARY STATEMENT OF FACTS.

The Power Company is a corporation that is organized and existing under the laws of the state of Colorado, with its principal office in the city of Pueblo in said state. The operations of the Power Company are confined to the production and distribution of electric power within said city and the territory immediately adjacent thereto. It also operates a street railway system in said city. It is strictly a solvent operating electric utility company within the purview of said Act and neither owns nor controls any other subsidiary utility company.

The total long term debt of said Company as the same existed at the time of the hearing before the District Court, after the refunding of its first mortgage bonds, as authorized by the Commission, was in the amount of $6,768,566 which was segregated as follows:

(1)	Thirty year first mortgage 3 1/2% bonds	$5,500,000
(2)	Ten year Serial Promissory 3% notes	$1,200,000
(3)	Paving and flood tax assessments	$68,566

The capital stock of the company was as follows:

(1)	42,516 shares of 7% cumulative preferred capital stock having a par value of $100 per share	$4,251,600
(2)	110,000 shares of Class A Common capital stock having a par value of $25 per share	2,750,000

(3) 75,000 shares of Class B Common capital stock, without par value but having a stated value of $10 per share	750,000
Total	$7,751,600

(a) The preferred stock is entitled, under the charter of the company, to cumulative dividends of $7 per share per annum, payable quarterly; to voting rights in event of default; to priority of the par value thereof and all arrearages in the liquidation, dissolution, or winding up of the Company; and to an amount of $110 per share on call or redemption, together with all accumulated dividends. This stock has no voting rights unless dividends are in arrears.

(b) The Class A common stock is entitled to dividends of $3 per share per annum, if earned; to share in the liquidation or dissolution of the company, to the amount of $27.50 per share, after payment in full of the par value of all preferred stock, together with accumulations thereon; and to an amount of $35 per share, on call or redemption. This stock has no voting rights under any condition.

(c) The Class B common stock is entitled to participate equally in any surplus, on liquidation or dissolution of the company, with the Class A common stock, after payment in full of the par value of the preferred stock, together with all accumulations thereon and after payment of $27.50 per share to the Class B shareholders. This stock is entitled to full voting rights (R. 58, 59).

The Standard Gas and Electric Company, a Delaware corporation, with its principal place of business in Chicago, Illinois, is a registered public utility holding company, within the provisions of said Act, and owned

360 shares of the preferred stock, 6,247 shares of the Class A common stock and all of the authorized and outstanding shares of the Class B common stock (R. 60). The Commission in its brief (page 39), however, asserted: "The Commission has ordered Standard Gas to divest itself of its holdings of southern Colorado securities under Section 11 (b) (1)."

The Standard Power and Light Company, a Delaware corporation which is likewise a registered holding company, and the parent of Standard Gas, owned and now holds 23,570 shares of the Class A common stock, unless the same was distributed to its shareholders, on dissolution, under order of the Commission. The balance of the preferred and Class A common stock is held by the public and the same is widely scattered.

By reason of current dividend arrearages on the preferred stock, the same now represents 36.18% of the voting power of the Power Company. The balance of the voting power, namely, 63.82%, is held by the Class B common stock, all of which, as above set forth, was owned and held by the Standard Gas and Electric Company, or now by the shareholders thereof, on dissolution, as directed by the Commission.

Dividends have not been paid in full on the preferred stock since 1932. Such annual payments during said period have never exceeded $4.25 per share and in all years but one have been less than that amount. Preferred dividends in arrears, neither declared nor paid, as of February 28, 1944, amounted to $35.50 per share and at the time of the hearing before the District Court aggregated approximately $1,509,318 (R. 46).

No dividends have been declared or paid on the Class A common stock since 1932, and no earnings have been available for the payment thereof since 1933.

No earnings have ever been available for dividends on the Class B common stock and none have been declared or paid (R. 47).

The amended plan of "reorganization" or "Recapitalization" as the same is referred to, that was proposed by the Power Company and approved by the Commission and the Court provides in substance for (1) the cancellation of all dividend arrearages on the preferred stock; (2) the authorization of 452,160 shares of new common voting stock without nominal or par value, of which 94.03% thereof namely 425,160 shares, are to be issued and distributed to the preferred shareholders in exchange for their shares and all unpaid accumulated dividends in arrears thereon; 4.86%, namely, 22,000 shares thereof are to be issued and distributed to the Class A common shareholders in exchange for their shares, and 1.11%, namely, 5,000 shares are to be held in the treasury of the company (R. 112). The Class B common shareholders are to be eliminated entirely from all further participation in the company.

In order to accomplish this change of capitalization, the officers of the Power Company have been directed to execute a certificate of amendment to the certificate of incorporation and to file the same in the office of the Secretary of State of Colorado. This Certificate of Amendment as submitted by the Commission provides that all of the outstanding certificates of the preferred and Class A common stock are to be surrendered to the corporation in exchange for certificates for new common stock in the proportions set forth above and that the Class B common stock is to be "null and void and cancelled" (R. 116).

The plan was never submitted to the stockholders for approval and the same is to be imposed by the Commission and the Court without their sanction. Furthermore, no consent or approval is to be obtained from the

shareholders for the proposed amendment to the Articles of Association of the Company as required by the statutes of the state of Colorado.

At the hearing before the Commission on the fairness of the Plan, all evidence of reproduction cost or present valuation was excluded, and it was conceded by all parties that the assets of the company were less in amount than the long term debt and the par value of the preferred stock excluding the accumulations thereon. The Commission stated:

> "On the basis, therefore, of obviously necessary adjustments in book values, it is apparent that there is no book equity for the Class B or Class A stock" (R. 22).

The Commission held that on reorganization, the total new common stock to be issued, namely 447,160 shares, would not justify a stated capital value of more than $4 or $5 a share, or an over-all total share valuation, at the utmost, of approximately $2,235,800. This represents a reduction of approximately $50 a share of the par value of the present issued and outstanding preferred shares (R. 39).

The Commission, therefore, has predicated the fairness of the plan and the distribution of new common stock entirely on an attempted appraisal of the future net earnings. For this purpose it has estimated that the net earnings on a *pro forma* basis for the year 1942 were $312,000 and for the years 1942-44 averaged about $311,000 per year.

> "The estimated *pro forma* net income of the Company for the year 1942 after the adjustments previously discussed is $312,000. The annual dividend requirement on the present preferred stock is $297,612.

Thus it is estimated that after the refinancing, preferred requirements will be somewhat more than covered" (R. 26, 27).

"Estimated *pro forma* income for the years 1942-44 averages about $311,000 per year" (R. 29).

This of course, is a mere estimate, but is the basis on which approximately five per cent of the new common stock has been allocated to the holders of the Class A common shareholders, and only ninety-four per cent thereof, to the present cumulative preferred shareholders.

The Commission summarizes the basis of this allocation in the following language:

"In many situations, not all income is available for dividend purposes. The circumstances mentioned above make it more likely in this case that prospective income is an accurate approximation of the amounts available for dividend purposes. While the existence of an accumulation of the preferred dividends of over $1,300,000 would make it impossible for the Class A stock to receive any dividends for a number of years, we think that there is sufficient possibility that the Class A stock might *some time* receive *some income* from the company to warrant participation by the Class A stock in the reorganization" (R. 28) (Italics ours).

One of the Commissioners dissented from the findings of the Commission and stated:

"*Pro forma* net income for 1942 is estimated in the majority opinion at $312,000. Annual preferred requirements are $297,612.

"Let us see on the basis of these figures how long it would take to eliminate the dividend arrearages. The *pro forma* estimate of net income of $312,000 exceeds the annual preferred dividend requirement of $297,612 by $14,388. Arrearages outstanding on the preferred stock were $1,367,598 at October 31, 1942.

Thus, even if all earnings could be paid out (an impracticable assumption), it would take 95 years to pay off the arrearages. I believe that a potential right to receive some extra dividends (34c a share) —if earned—95 years from now is not compensation for the surrender of preferred status. When common stock can not be expected to participate for so many years I do not believe it has a value.

"As I have pointed out, the majority have concluded that annual net earnings will exceed $312,000 by some amount. I have searched their opinion in vain for a statement of what they expect the earnings to be. In the absence of such a statement I cannot comment on it" (R. 49, 50).

As above set forth dividends on the preferred stock have been in arrears since 1932. For such years the actual net earnings, even after excluding the street railway operations and computing depreciation at the same amount as in the *pro forma* statement, were less than the amount required to pay dividends of $7 per share on the preferred stock and exceeded said sum in the other two years by only trifling amounts. The indenture securing the new issue of refunding bonds moreover, contains added restrictions against payment of dividends; namely that at least 16% of gross operating revenues of the electric department, less costs for electricity purchased and rental of equipment shall be utilized for replacements, maintenance and construction; that earned surplus shall be restricted against payment of dividends in an amount equal, if any, by which such 16% of gross revenues exceeds the aggregate charges to operating expenses for maintenance and depreciation; that a sinking fund of at least $120,000 a year be set aside for payment of the serial votes and that an additional amount of $120,000 a year be retained out of earnings during the first ten years and that, in subsequent years an amount equal to

the sinking fund requirements for that year, less certain stated deductions be retained (R. 63).

The Commission stated many times in its report that the properties of the Company are obsolete and inefficient. The revenues in the past twelve years have manifestly therefore not been sufficient to even properly maintain the equipment even though payments in full have been withheld from the preferred shareholders.

> "But no one in his right mind would think of reproducing, either in 1937 or at the present time, the obsolescent, small and inefficient generating units owned by southern Colorado instead of erecting a modern generating plant or plants to produce power" (R. 23).

The cumulative, preferred capital stock of said Power Company that are owned by Petitioner, were purchased by his father more than thirty years ago. The great majority of the shares of such preferred stock are held by widely scattered shareholders, no one of whom owns more than a small number of the same. The largest owner thereof was the Standard Gas and Electric Company with 360 shares. Petitioner appeared by counsel before the Commission and protested approval of the Plan. He also filed formal objections before the District Court (R. 101).

REASONS FOR APPLICATION FOR WRIT.

This Court in the case of *Otis and Company* v. *Securities and Exchange Commission*, 89 L. Ed. (Advance Opinions) 460, on January 29, 1945, held that the Commission was within its authorized powers to distribute the assets of a holding company among its shareholders, as a going business and not as though a liquidation had in fact taken place. It is not intended by this petition to review, in

any respect, the questions that were presented and decided in that case. The situation presented by this petition concerns instead a recapitalization of a solvent operating public utility company, as distinguished from the dissolution of a holding company, and involves the right of the Commission to direct, not only a modification of capital structure, but also a complete reorganization of such a company. The questions, therefore, to be determined by the petition are

(1) Whether the Act authorizes the Commission to reorganize an operating public utility company that neither owns nor controls any other subsidiary utility company and by such process to compel preferred shareholders to relinquish their preference status together with the other charter rights accorded to them, and to share with the common stockholders in a new issue of common stock;

(2) Whether the plan approved by the Commission and the Court is necessary and appropriate to effectuate the provisions of the Act;

(3) Whether the plan approved by the Commission and the Court is fair and equitable to the holders of the cumulative preferred stock;

(4) Whether the Commission and the Court are acting within the intendment of the Act in directing an amendment of the charter of the Power Company without the consent or approval of the shareholders thereof as required by the laws of the state of Colorado;

(5) Whether, in the event, it is held that the enforcement of the plan is authorized by the Act as so construed by this Court, said Act denies to the preferred shareholders equal protection of the laws and deprives them of

their property without due process of law, in violation of the provisions of Amendment V to the Constitution of the United States.

REASONS RELIED ON FOR ALLOWANCE OF THE WRIT.

(1) The Circuit Court of Appeals was in error in affirming the order of the District Court in approving the plan of reorganization as fair and equitable to the preferred shareholders of the Power Company and in holding that such action was necessary and appropriate to effectuate the provisions of the Act.

(2) The issue involved, insofar as the same affects the right of the Commission and the Court to approve a plan of reorganization of a solvent operating public utility company, that neither owns nor controls any other subsidiary utility company, constitutes an important question of Federal law which has not been determined by this honorable court.

(3) The issues presented are of great concern to shareholders of solvent operating public utility companies and are of sufficient importance to warrant a determination by this honorable court.

PRAYER.

Wherefore, your petitioner respectfully prays that a writ of certiorari be issued out of and under the seal of this honorable court, directed to the United States Circuit

Court of Appeals for the Tenth Circuit, or if its mandate has gone down, to the United States District Court for the District of Colorado, commanding the Court to certify and send to this court for its review and determination, on a day certain to be therein named, a full and complete transcript of the record and proceedings in the case in said Circuit Court, number 2916, or in the District Court Civil, number 670; and that the decision of the United States Circuit Court of Appeals for the Tenth Circuit affirming the order of the District Court be reversed by this honorable court, and that your petitioner have such other and further relief in the premises as to this honorable court may seem mete and just.

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State of Missouri, Jackson County, ss.

Be It Remembered, that on this.....day of April, A. D. 1945, personally appeared before me, a Notary Public for the State and County aforesaid, Armwell L. Cooper, who, being by me first qualified according to law, did

depose and say that he is an attorney for the petitioner named in the foregoing Petition; that he has read the foregoing Petition and that the facts set forth therein are true so far as the same relate to his own acts and deeds, and so far as the same relate to the acts and deeds of any other person or persons, he believes them to be true; and that this Petition is not filed for delay.

(Signed) Ormond L. Cooper

Sworn to and subscribed before me the day and year first aforesaid. My commission expires June 5-19

(Signed) Edith Gibbs

Notary Public.

(Seal)